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The Comparison of Opening up in Banking Industry between US and China

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Abstract

As a result of the full opening up in China's banking industry in 2006, foreign banks have gained more power in the market. On the one hand, it exerts a lot of pressure on domestic banks; on the other hand, it becomes a significant challenge for China's financial security. As a country opening up much earlier than China, United States may offer some ideas on how to avoid mistakes in the opening process. This article discusses what China can learn from US experience through the comparison in the openness of banking industry.

Keywords: WTO, Financial and trade liberalization, Comparison

1. Introduction

The opening up financial industry is not only one of the most important goals for service trading liberalization, but a significant promise our country made when joining the WTO. In the several round of the negotiations on the issue of China's joining, almost all the negotiating parties, especially developed countries, put forward a relatively high demand on the openness of financial industry. In order to join the WTO, China had to make a promise to open up financial industry in a planed and steady way, and the Schedule of Specific Commitment in the documents appended thereto of the Agreement on Financial services is a measure of the degree of openness

Because banking is the cornerstone of the financial industry, the degree of banking openness decides that of the financial industry in a large part. Therefore, the study of banking openness has been one of hot topics both in the academic field and practice field. Many researchers discuss the challenges and competition we face after join the WTO, so does the strategy to fight against the foreign banks. However, in order to find out the way to strengthen the domestic banks, attention should be paid not only on what we can do inside the country, but what others had done outside the country. We should learn the experience of other countries in order to spot out China's shortage in banking and improve it. United States is the major financial power in the world, and the comparison between US and China can give us some ideas on how to strengthen China's own financial power.

2. Discussion

2.1 The comparison of opening up banking industry between US and China

In the section, the comparison about opening up of banking industry will focus on three aspects: goals, mode and results. From the analysis of the similarity and difference, we hope to find out China's shortages and the way to adjust it.

2.1.1 The comparison of the goals

Achieving the financial service liberalization and increase the welfare of whole world is the common goal. Nowadays, the distribution of financial resources is uneven in the world. On the one hand, developing countries is extremely lack of capital and eager to find the capital resources to support their economy development; on the other hand, the developed countries own a lot of capital surplus and need to invest effectively and make a profit. The financial service liberalization, especially the capital flow and investment liberalization can reduce or even remove the barriers of the flow of financial resources, strengthen the connection of the financial markets in different countries and increase the welfare as a result.

The difference of the financial power decides the different goals of financial openness. US financial market had been highly developed before signing the agreement of opening. Therefore, the openness of banking has little influence in the market. However, joining the multilateral trade in financial industry gives US a chance to enter other countries' markets with much fewer barriers. As for China, on the one hand banking has transformed from planed economy to market

economy after 20 years reform. There are some powerful banks in China in terms of strength and effectiveness, which means China has the capability to response the attack caused by opening up. On the other hand, due to the local government's intervention, the regulation of the banking is not appropriate enough and the relationship inside is very complicated. It needs outside competition to improve its effectiveness and quality.

2.1.2 The comparison of the modes

The figure 1 and figure 2 shows the differences of limitations on market access and national treatment.

	Banking in China	Banking in US
Geographic Limitation	For foreign currency business, there will be no geographic restriction. For local currency business, foreign services Suppliers may provide business in 20 major cities. Within five years after accession, all geographic restrictions will be removed.	There are few federal geographic limitations. But the rules of entry in the states are various, in term of initial entry of expansion by a foreign person, the citizenship of boards of directors, the establishment of a direct branch or agency by a foreign bank.
Clients Limitation	For foreign currency business, foreign financial institutions will be permitted to provide services in China without restriction as to clients. For local currency business, foreign financial institutions will be permitted to provide services to Chinese enterprises. Within five years after accession, foreign financial institutions will be permitted to provide services to all Chinese clients.	In order to accept or maintain domestic retail deposits of less than $100,000, a foreign bank must establish an insured banking subsidiary. This prohibition does not apply to a foreign bank branch that was engaged in insured deposit-taking activities on December 19,1991
License available	Criteria for authorization to deal in China's financial services industry are solely prudential. Within five years after accession, any existing non-prudential measures restricting ownership, operation, and juridical form of foreign financial institutions, including on internal branching and licenses, shall be eliminated.	No branch or state agency license available in some states. All directors of a national bank must be citizens unless a national bank is an affiliate or subsidiary of a foreign bank, in which case only a majority of the board need be citizens.

Figure 1. Limitation on Market Access

Resources: UNITED STATES OF AMERICA Schedule of Specific Commitments

China's Schedule of Specific Commitments

	Banking in China	Banking in US
Cross-border Supply	None	None
Consumption Abroad	None	None
Commercial Presence	Except for geographic restrictions and client limitations on local currency business (listed in the market access column), foreign financial institution may do business, without restrictions or need for case-by-case approval, with foreign invested enterprises, non-Chinese natural persons, Chinese natural persons and Chinese enterprises. Otherwise, none.	Foreign banks are required to register under the Investment Advisers Act of 1940 to engage in securities advisory and investment management services in the United States, while domestic banks are exempt from registration. Foreign banks cannot be members of the Federal Reserve System, and thus may not vote for directors of a Federal Reserve Bank. Foreign-owned bank subsidiaries are not subject to this measure. Branch, agency and representative offices of foreign banks are required to be charged for the cost of Federal Reserve examinations.
Presence of Natural Persons	Unbound except as indicated in horizontal commitments.	None

Figure 2. Limitation on National Treatment

Resources: UNITED STATES OF AMERICA Schedule of Specific Commitments

China's Schedule of Specific Commitments

From the figures above, we can see that limitations in US are fewer from the appearance, but more in fact. There are few federal limitations, and US give foreign banks almost fully national treatment. However, there are many intangible trade barriers. First, the limitations on market access are different among states, so does the national treatment, which can be the huge barriers for foreign banks that plan to strength their power in terms of size and capital. Second, the financial regulation system in US is very complicated, foreign banks have to deal with multiple regulations, and accept harsh openness control and business control if they want to broad their business. In addition, United Stated has published action in 1997 to regulate foreign banks before signing Financial Service Agreement.

China, in the contrast, has more limitations in appearance, but fewer in fact. In order to ensure the stability and development of financial system, the opening up of banking has followed in proper sequence. Geographically speaking, the opening regions are from developed area to less developed area. In terms of business affairs, the openness is from foreign currency business to local currency business. It also carried out other methods to control the speed of openness, such as administrative approval system, qualification research, licensing quantity limitations, operation regulations, etc. However, foreign banks have been given sub-national treatment in practice in the aspects of income tax, business coverage, loan income and pre-tax bad debt cancel. For instance, the tax rate of foreign exchange earning is just 15 percent for foreign banks, compared to 33 percent for domestic banks, let alone other tax preferences.

2.1.3 The comparison of the results

There have been 62 countries establishing foreign banks in United States before December 31st, 2002, including 246 branches of foreign banks, 54 bank sub-agencies, 78 foreign bank holding companies, 4 Edge companies which the foreign banks holding is above 25 percent, and 165 agencies. The assets of foreign banks in US are $134 billion, accounting for 18.3 percent of the total assets in the commercial banking system. The branches and agencies just operate wholesale business and do not work in retail business. The loan business of foreign banks accounts for 1/5 of the total. However, these statistics have no significant change in the period from 2002 to 2007. It seems that signing the Financial Service Agreement has no influence in US banking. It is the result of the developed macro economy. In 1990s, the financial industry in US has highly developed, and the opening up of banking is in the condition of stable economy. As a most developed country, there is almost no pressure after its opening up. As a result of the capital inflow, it has satisfied the demand for financial services and added US banks' competitive strength. The stable economy makes the opening up of banking possible, and the opening up of banking improves the banking system and increases its internationalization in reverse.

According to the research, there are 20 solely foreign-owned banks with 95 branches in China before the October, 2007, and the share-holding bank is 3 with 5 branches and1 subsidiary. 72 foreign banks from 22 countries have established 130 branches. The total assets are $153.9 billion, accounting for 2.24 percent. In terms of market share, the foreign banks have no advantages, but they attracted significant amount of clients with high incomes relying on their financial products and high-quality service, which exert huge pressure on domestic banks. However, the achievement of openness is obvious. The major state-owned banks have introduced advanced mode of company governance and reform the banking system step by step. They have established the basic infrastructure of modern companies so far, especially in the non-performing loan problem. In recent years, both the non-performing loan and ratio of that have decreased significantly. After the all-round opening up in 2006, the major domestic commercial banks have to change the mode of relying on deposit and loan business only facing the fierce competition. They pay more attention on the possibility of full-service banks, and tried their best to reduce the risk and bad debt. The figure 3 is the recent years performance of the major commercial banks in China in the aspect of non-performing loan.

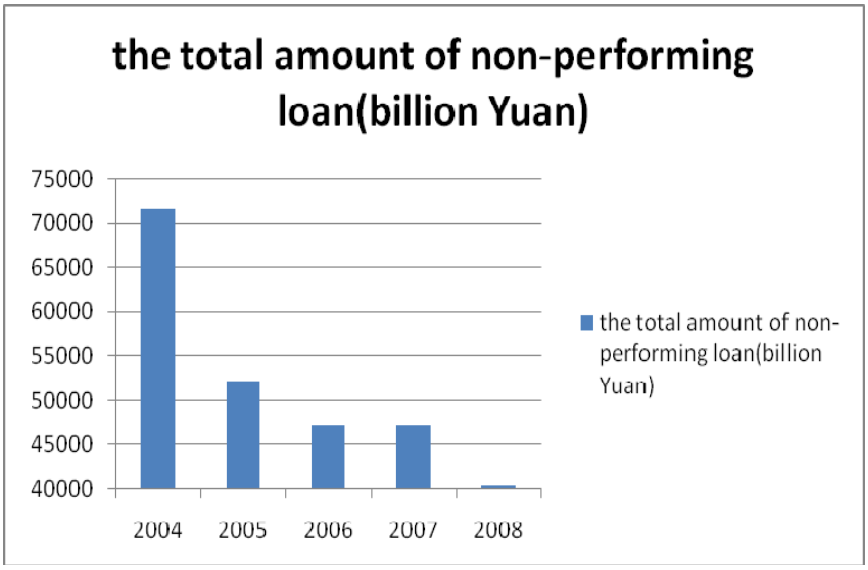

Figure 3.

2.2 What we can learned from the comparison

From the comparison of goals, modes and results, we can see that there are many differences between the openness of US and China. In order to make it clearer, we should look inside these differences and find out the experiences.

2.2.1 The stable economy is the premise of opening up

The development of banking is on the premise of the stable economy. The reform and opening up of the banking only responds to the requirement of the economy. In reverse, only if the economy develops steadily the reform and opening up of banking can be effective and the monetary disturbance will not take place. The International Economic Research Center in Washington, US has analyzed about 200 cases of monetary disturbance in the world, and pointed out that there are 6 economy warning index on whether the country is in monetary disturbance; that is real exchange rate, trade environment, capital, stock price index, real economy development, the increase of currency issue and the real trade level. These 6 indexes have different indications of monetary disturbance, but only if all indexes are stable, financial industry can develop steadily. At the same time, we should know that the opening up is just a method to accelerate the reform of the banking system. In terms of power and stability, the economy and the degree of banking development is much higher than that of China. As a result, the total assets accounting of foreign bank is much higher than that of China.

As for China, the degree of opening up of banking industry has to adjust with the current condition of economy. The development of China's economy is very fast in recent years. However, the health development should not only embody on GDP, but on the stability. Therefore, the opening up of banking industry should follow in a cautious way. That means the licensing system should be completed gradually and the license quantities' increase should fit the demand of the economy. Finishing the whole thing just in on step is not acceptable.

2.2.2 Effective regulation is the base of opening up

As we mentioned above, the regulation of foreign banks is very complicated in United States, not only from Federal level but the state level. In addition, the regulation institutions are different in different business affairs. In terms of Fed

level OCC, FED, FDIC, OTS and NCUA are included. There are two major regulation indexes in US. One is the requirement of equivalency for assets and deposits. According to the US law, foreign banks must deposit certain quantity of cash or other valued securities in appointed banks (usually domestic banks). Other one is the requirement of assets remains. In order to protect the benefits of public and debt owner, Fed requires all the foreign banks remaining enough assets to pay their debts in US. In recent years, in order to adapt the changes of financial environment, the regulation institutions have reduced the limitations of banking in the aspects of capital, business affairs, geographic operations, rate level, etc. However, they strengthen the regulations of banking as a whole, realizing the changes from regular regulations to risky regulations and emphasizing the role of the market.

The major regulation institutions in China are China Banking Regulatory Commission and the People's Bank of China. Compared to planed economy, the mode of regulation has been changed. For instance, the control on the loan quantity has been given up and there are fewer government's interventions in the capital markets. However, government still over regulates banks' regular operations and the market does not work effectively. To realize the internalization, the government's overregulation should be removed and the market forces strengthened.

2.2.3 The optimized law system ensures the safety of opening up

When analyzing the law system in the US, especially in banking law, we can see that the law relating to foreign banks is much more than that in China. The International Bank Act (IBA) published in 1978 is the major law relating to foreign banks in the US, and RNIBBA published in 1994 is a complement to IBA, which provides the mode to establish branches across the states. There are just 18 states in the US agreeing foreign banks to establish new companies as their branches.GLB published in November, 1999 summarized and completed the financial laws published in the recent10 year's period.

Since joining the WTO, China's government has published the banking related law, including the Cancellation Rules of Financial Institutions, the Rules on Foreign Financial Institutions, etc. These laws are not only a complement to China's law system, but a standard of behavior for foreign banks entering China's market. However, the result is not as good as government's prediction. In some regions, for instance, foreign banks gain sub-national treatment. To a great relief, the PBC and State Council have been engaged in solving the problems. It is clear that the law cannot be optimized in short period, but the openness of the policy is an effective way to realize the goal.

3. Conclusion

Through the comparison of opening up in banking industry between the US and China, we can see that there are similarities and differences in the goals of opening up, so does the modes, but the results turn out to be good. Despite the existing deficiencies, the efficiency of domestic banks in China has increased significantly. In order to remove these deficiencies, the law system should be optimized and the regulation of banking should be reinforced in appropriate way. Above all, the stable economy is the cornerstone of the health of banking system.

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